Moody's Investors Service

Global Credit Research
New Issue
9 JAN 2007

New Issue: Springfield (City of) MA

MOODY'S ASSIGNS UNDERLYING Baa3 RATING TO CITY OF SPRINGFIELD'S (MA) $126 MILLION GENERAL OBLIGATION BONDS AND REVISES OUTLOOK TO STABLE FROM NEGATIVE; ENHANCED Aa3 RATING WITH STABLE OUTLOOK ALSO ASSIGNED

Baa3 UNDERLYING RATING WITH A STABLE OUTLOOK APPLIES TO $363 MILLION OF PARITY DEBT, INCLUDING CURRENT OFFERING

Municipality
MA

Moody's Rating

ISSUE	UNDERLYING RATING	RATING
General Obligation State Qualified Municipal Purpose Loan of 2007	Baa3	Aa3

Sale Amount	$126,000,000
Expected Sale Date	01/16/07
Rating Description	General Obligation State Qualified Bonds

Opinion

NEW YORK, Jan 9, 2007 -- Moody's Investors Service has assigned an underlying rating of Baa3 to the City of Springfield's $126 million General Obligation State Qualified Municipal Purpose Loan of 2007 Bonds and revised the outlook to stable from negative; an enhanced rating of Aa3 with a stable outlook has also been assigned to the bonds. Concurrently, Moody's has affirmed the Baa3 rating and revised the outlook to stable from negative, affecting $237 million in outstanding general obligation bonds. The bonds are secured by the city's general obligation limited tax pledge as debt service has not been voted exempt from the levy limitations of Proposition 2 ½. Of this issue, approximately $53 million is issued to finance capital projects including the city-wide installation of energy-saving building fixtures and the installation of a centralized financial accounting and reporting system. The remainder of approximately $100 million is issued to refund outstanding general obligation debt originally issued for school and city capital needs, with an anticipated present value savings of approximately 3%. Although the city expects the refunding to yield up to $3.4 million in savings over the life of the bonds, approximately two-thirds of the savings is related to bonds originally issued for school projects, and future commonwealth debt service reimbursements will be adjusted downward to reflect the associated savings.

Affirmation of the underlying Baa3 rating reflects an improving financial position, highlighted by increasing reserves and reduced reliance on cash flow borrowing after several years of reserve depletion and impaired liquidity, a sizeable tax base with a below-average wealth profile which provides significant regional employment opportunity and governmental services, and a moderate debt profile heavily supported by state reimbursements. Revision of the outlook to stable from negative reflects Moody's recognition of the significant progress achieved by the Springfield Finance Control Board (FCB) and the city's management toward resolution of serious financial problems including significant operating deficits, outstanding collective bargaining contracts, need for the replacement of antiquated and inefficient systems, management of escalating expenditure pressures and development of fiscal policies and long-range planning strategies designed to provide stability and to address the city's significant operating and capital needs. Operating surpluses achieved in fiscal 2005 and 2006, due largely to loans from the commonwealth and nonrecurring revenues from delinquent tax collections, have improved the city's cash position, reducing the city's need for cash-flow borrowing.

MAJORITY OF DEBT ENHANCED BY QUALIFIED BOND PROGRAM

The enhanced Aa3 rating and stable outlook, assigned to all but one of the city's outstanding long-term bond issues, reflect the credit enhancement provided by the Commonwealth of Massachusetts' Qualified Bond Program. The program is a direct-payment system whereby the Commissioner of Revenue authorizes the State Treasurer to deduct from the city's quarterly state aid payments an amount sufficient to meet the city's debt service on qualified securities. In fiscal 2006 Springfield received aid from the commonwealth totaling more than eight times the city's obligation for debt service. The State Treasurer makes debt service payments directly to a state-approved paying agent on behalf of the city. Moody's believes that the commonwealth's strong commitment to state aid for municipalities and the program's sound payment mechanisms, which do not rely on the trigger of a notice of potential default, enhance the likelihood of full and timely debt service payment. The programmatic rating is linked to the commonwealth's general obligation rating of Aa2 with a stable outlook.

SPRINGFIELD FINANCE CONTROL BOARD

The FCB was established in July 2004 to secure the financial stability of the city after several years of significant operating deficits, depleted reserves and other accumulated financial liabilities in the city's internal service funds including health insurance. The FCB will continue to exist until at least June 30, 2007; the members can vote to extend its legal authority at any time. The FCB, which consists of five members: three designated by the Commonwealth's Secretary of Administration of Finance, the city's mayor and the president of the city council, has broad financial and administrative powers established under the FCB's enabling legislation. An additional provision of the legislation allows the city access to a $52 million trust fund, with aggregate borrowing to be fully repaid, albeit without an interest charge by fiscal 2012; the city's net borrowing from the trust fund is approximately $26 million. The legislation also includes a mechanism by which the commonwealth could move the city into receivership, if the FCB is unable to restore fiscal stability, which would abolish the office of the mayor and place all powers of the mayor with a receiver appointed by the commonwealth. Today's rating action reflects the progress achieved by the FCB and Moody's belief that the existence of the FCB remains critical for stability and continuity as new policies and administrative changes are implemented. The rating also incorporates uncertainty as to the length of the control board's tenure, the terms for repayment of the trust fund loan and the level of attention and support the city will receive from the commonwealth going forward.

IMPLEMENTATION OF COMPREHENSIVE COST CONTROLS EXPECTED TO YIELD OPERATING SAVINGS

Under the direction of the FCB, the city has undertaken a comprehensive review and restructuring of departmental operations, which are projected to yield aggregate annual departmental expenditure savings of approximately 2% in the medium term. Of particular note, the treasurer's office has collected over $19 million in delinquent taxes and penalties in fiscal 2005 and 2006, significantly improving the city's cash position and reducing the city's reliance on cash flow borrowing. In January 2007 the city successfully transferred administrative responsibility for employee health benefits to the commonwealth's Group Insurance Commission (GIC), which has experienced favorable annual cost increases approximating 9%, significantly lower than the city's history of 15% increases. Participation in the GIC is expected to yield significant long-term and immediate annual savings, if proposed changes to the health plan are implemented.

After several years of below-average investment returns and costly early retirement incentives, the city's unfunded actuarial accrued liability (UAAL) for its pension obligations has increased to over $372 million at January 2005. In an effort to streamline administrative costs and enhance investment return, the assets of the Springfield Contributory Retirement System were transferred in August 2005 to the commonwealth's Pension Reserves Investment Trust (PRIT) whose 20-year annualized investment performance averaged over 11%. Although in the near term the city's annual pension contribution increases significantly to meet the newly-adopted funding schedule with a statutory 2028 full-funding deadline, city officials project that investment returns should more closely approximate the city's actuarial assumption of 8.5% and moderate future pension contribution increases.

Finally, and most notably, Springfield has settled 27 of its 28 of its outstanding labor contracts, covering 98.4% of the city's represented employees and eliminating a potential $40 million liability for retroactive salary increases related to a wage freeze in 2004, and providing significant predictability in labor costs in the medium term with annual payroll increases projected at 3.1%, assuming the maintenance of current employment levels. The city has also appointed new police and fire commissioners and although expenditures may increase in the near term due to the city's need to address serious city-wide public safety issues, officials report that each department is undergoing thorough reorganization to modernize operations and improve effectiveness of public safety services. Upon completion of the FCB's initial review of city departmental operations, a thorough review of the school system, which represent 62% of the city's fiscal 2006 expenditures, has been launched and, while it is too early to project dollar amounts, management anticipates the identification of opportunities for future operating savings.

RETURN TO STRUCTURAL BALANCE ANTICIPATED

Moody's expects Springfield's financial position to continue to show modest improvement, although significant challenges remain in balancing future budgets without the use of non-recurring revenue sources. Operating performance in fiscal 2006 shows a healthy operating surplus of $31.5 million and an improved general fund balance of $83.8 million or a healthy 16.7% of general fund revenues, a notable increase over the extremely slim general fund balance of just under $8 million (1.9% of revenues) in fiscal 2003. Undesignated general fund balance has also improved to $38.3 million (7.6% of revenues) and the city's certified free cash is expected grow to approximately $10 million, only the second positive balance since 1988 and a dramatic improvement from the city's fiscal 2002 balance of negative $57 million. However, budget gaps in fiscal 2005 and 2006 were resolved with long-term draws totaling nearly $26 million from the commonwealth trust fund that accompanied the creation of the FCB, and final terms for repayment or relief from the trust fund loan have not yet been determined and, while the city has reserved $4.6 million for repayment of the loan, could exert significant pressure on future operating budgets. The adopted fiscal 2007 budget includes expenditure increases of $33.7 million, due largely to salary increases mandated by new collective bargaining contracts, which necessitated the appropriation of one-time revenues totaling $12.7 million--$6.7 million from certified free cash and $6 million from the overlay surplus-to balance the budget. Additionally, implementation of a new solid waste removal fee, representing up to $2.6 million in budgeted revenue in fiscal 2007, has been challenged by residents and although management ultimately anticipates a favorable outcome for the city, resolution may not be reached in time to collect much of the budgeted 2007 fees; an additional draw on the trust fund has been approved to balance the budget to replace the lost revenue, if required. Springfield remains constrained in its ability to raise additional revenues under Proposition 2 ½, and preliminary projections for fiscal 2008 show a budget gap of up to $7.2 million, including budgeted revenues of $4 million from solid waste fees. City officials indicate that the budget could be balanced by level-funding each department for a savings approaching $18 million, however the city anticipates that the gap will be closed through additional expenditure reductions including anticipated further health care savings, tax base growth and the identification of additional recurring revenue sources.

The city's liquidity has improved, primarily due to the proceeds from the commonwealth loan and the $19 million back-tax collection, and the frequency and amount of short-term borrowings fell to just one $12 million loan in fiscal 2006 after 12 borrowings totaling $100 million in fiscal 2005. Other than the proposed draw to provide revenue to replace the contested trash fees, no additional borrowing from the trust is anticipated in fiscal 2007 or future years. The city received 63% of its fiscal 2006 general fund revenues from the commonwealth and federal governments and 26% from property taxes, which are levied near the limit under Proposition 2 ½. Property tax collections have improved to a healthy 98.7% in fiscal 2006 from 94% in fiscal 2003. Moody's believes that the city will remain challenged to replenish appropriated free cash and maintain reserves at levels that keep pace with revenue growth. Critical to the city's ongoing financial recovery will be adoption and successful implementation of management's comprehensive financial policies, including a targeted minimum undesignated fund balance of revenues (less debt exclusions and chapter 70 education aid, a less conservative measure than Moody's ratio using total general fund revenues) at a maximum of 15% of city-defined net revenues. Despite the long-term certainty provided by the city's collective bargaining contracts, recently settled through fiscal 2012 (although the teachers' contract expires in fiscal 2010, representing nearly half of the city's 5000 municipal employees), the city faces ongoing expenditure pressure from salary-related expenditures as pension contributions increase to improve the current 42.6% funding status and meet the commonwealth's required full-funding deadline of 2028. Although funding of OPEB liabilities is not required in Massachusetts, the city plans to comply with GASB 45 reporting requirements and has identified a preliminary unfunded accrued actuarial liability of up to $450 million; future funding for this liability above the current pay-as-you-go level of $57 million has not been budgeted and could exert additional expenditure pressure in the future.

CITY'S TAX BASE EXPANDS ON PAR WITH NATION BUT GROWTH TRENDS STILL LAG REGION

Moody's expects that the city's $6.9 billion tax base will continue to grow moderately given ongoing development and the city's targeted development plans. The city is the center of economic activity in western Massachusetts, with health care, financial services, government, manufacturing and higher education sectors represented as major employers. The city's tax base has begun to experience moderate growth following a 30% decline in the early 1990's; equalized value growth has averaged 8.5% since 2001, slightly exceeding the national median of 8.3%, although this expansion lags the commonwealth median of 11.8%. Growth in assessed valuations over the past five years is healthier, averaging 9.4% annually, and fiscal 2006 building permit activity indicates that growth will be sustained, at least in the near term, to allow the city to meet or exceed its conservative new growth revenue projection of $2 million. City officials report that new growth is driven by single-family home construction and renovations as well as commercial development and newly-captured personal property levies. Not captured in the city's equalized value are the tax-exempt facilities of Western New England College and Law School (rated Baa2), Springfield College (rated Baa1), Springfield Technical Community College (not rated) and American International College (not rated); total enrollment is estimated at 24,300 while employment totals 2000 full-time-equivalent positions. Recent expansion of these institutions has yielded approximately $34 million in new educational facilities, underscoring the importance of the higher education sector as an important source of stability and growth to the local economy.

City officials plan to maximize tax base growth through implementation of a neighborhood development plan designed to target commercial redevelopment and blight reduction as well as roadway, parks and infrastructure upgrades. Funding sources have not yet been identified for every project, however the city expects significant private, federal and state participation in this initiative. Construction is already underway for a federal courthouse designed by architect Moshe Safdie, and other notable projects include roadway improvements to be funded by ongoing commonwealth Chapter 90 funding and a proposed $12 million private redevelopment of the former basketball hall of fame to become an entertainment and fitness facility. The city may offer tax incentives to private developers to encourage additional development but officials are evaluating the tax incentive policy before finalizing future agreements. Income and wealth levels in Springfield are significantly lower than state medians: the September 2006 unemployment level of 7.9% and the 1999 poverty level of 23.1% are significantly higher than commonwealth and national medians and the city's equalized value per capita of $45,832 is well below the commonwealth median of $120,181.

ABOVE-AVERAGE DEBT BURDEN DUE TO CAPITAL PLAN UPDATE AND STATE LOAN REPAYMENT

Moody's anticipates that the city's elevated direct debt burden (6.2% of equalized value) will increase over the medium term as the city begins to address accumulated deferred maintenance and other capital needs while also assuming the burden of repayment of the commonwealth's $26 million loan. The city receives annual reimbursement from the commonwealth for 90% of debt service related to bonds originally issued to finance school construction projects, which represent 63% of the city's outstanding general obligation debt. The city's debt burden falls to a still above-average 2.2% after deducting the expected school construction reimbursement, and gross debt service accounted for a moderate 6.9% of the city's operating expenditures in fiscal 2006. The city has recently updated its five-year capital improvement plan (CIP); this borrowing represents the first phase of up to $350 million in capital needs; financing plans for the remainder of the projects are incomplete at this time, however city management expects to leverage state and federal funding for up to 60% of the CIP. Furthermore, included in management's comprehensive proposed financial policies are prudent debt limits including maximum future general fund debt service of 5% of annual revenues and a minimum principal amortization schedule of 65% in 10 years.

Outlook

The stable outlook reflects Moody's belief that the FCB and city management have curtailed operating losses, and that Springfield's financial position is beginning to stabilize. While serious financial challenges remain, in recognizing opportunities for cost control and enhancing its administrative capacity, the city is better positioned to address the city's long-term financial health. Moody's anticipates that favorable resolution of the repayment terms of the trust fund loan, the school system review and ongoing efforts to spur economic development are critical to achieving structural balance.

WHAT COULD MOVE THE RATING UP?

*Effective multi-year planning resulting in balanced budgets without use of one-time revenues

*Adoption and adherence of Springfield's proposed comprehensive financial policies

*Additional operating surpluses and augmentation of reserves outpacing revenue growth

*Continued tax base expansion resulting in new growth revenue exceeding current levels

*Favorable resolution of repayment terms for commonwealth trust fund loan

*Ability to achieve progress toward required funding of pension and to address OPEB liabilities

WHAT COULD MOVE THE RATING DOWN?

*Deficit operations

*Failure to reduce reliance on one-time revenue sources in the medium term

*Reduced liquidity requiring a return to cash flow borrowing for operating needs

*Failure to maintain adequate control over operating expenditures

*Imposition of unfavorable trust fund repayment terms

*Reductions in state and federal aid below current levels

*Declines in tax base growth

KEY STATISTICS

2000 Population: 152,082

Proposed 2007 Equalized Valuation: $6.95 billion

2007 Equalized Valuation per Capita: $45,832

Average Annual Growth, Equalized Valuation (2001-2007): 8.5%

Direct Debt Burden: 6.2% of equalized valuation

Overall Net Debt Burden, adjusted for commonwealth school construction aid: 2.9% of equalized valuation

Amortization of Principal (ten years): 66.8%

1999 Per Capita Income: $15,232 (58.7% of commonwealth median)

1999 Median Family Income: $36,285 (58.8% of commonwealth median)

FY05 General Fund Balance: $50.95 million (10.3% of general fund revenues)

FY05 Undesignated General Fund Balance: $26.56 million (5.4% of general fund revenues)

FY06 General Fund Balance: $83.8 million (16.7% of general fund revenues)

FY06 Undesignated General Fund Balance: $38.3 million (7.6% of general fund revenues)

Post-sale long-term G.O.L.T. debt outstanding: $368 million ($363 million state-qualified)

Analysts

Susan Kendall
Analyst
Public Finance Group
Moody's Investors Service

Edith Behr
Backup Analyst
Public Finance Group
Moody's Investors Service

Contacts

Journalists: (212) 553-0376
Research Clients: (212) 553-1653